The Management University of Africa

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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

BCM 221: ACCOUNTING FOR LIABILITIES

DATE: ` 18TH JULY 2017

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided**

QUESTION ONE

On 1 January 2011 *Flanc Ltd* leased to *Denise Ltd* a new machine that cost sh. 60 million. The lease is a finance lease whereby *Denise Ltd* has to pay all executor costs and assume other risks and costs of ownership. The lessor computed the periodic payments at an amount that will yield an annual return on cost of 10% and the lessee also uses 10% to record the lease and calculate the interest expense. The machine is expected to have a nil residual value at the end of the four year lease term. Both the lessor and lessee have accounting years ending December 31.

Required:

a) Calculate the periodic lease payments throughout the lease term assuming the annual payments are payable at end of each year. **(5 marks)**

b) Calculate the periodic lease payments throughout the lease term assuming the annual payments are payable at the start of each year. **(10 marks)**

c) The income statement extract and statement of financial position extract as at the year 2011 for both cases (a) and (b). [Give extracts for both annual payments payable at the year end and payments payable at the year start]. **(10 marks)**

QUESTION TWO

The following is the statement of financial position of Halford Ltd as at 30 June 2011.

Assets	**sh. '000'**	**sh. '000'**
Non-current assets		
Property, plant and equipment		10,000
Goodwill		6,000
Other intangible assets		5,000
Financial assets (cost)		9,000
		30,000
Current assets		
Trade receivables	7,000	

Other receivables	4,600		
Cash and cash equivalents	6,700		
			18,300
			48,300
Equity and liabilities			
Share capital			9,000
Share premium			4,500
Retained earnings			9,130
			22,630
Non-current liabilities			
Long-term borrowings	14,000		
Deferred tax liability		3,600	
			17,600
Current liability			
Trade and other payables	5,000		
Current tax liability	3,070		
			8,070
			48,300

Additional information

i) The financial assets are classified as 'available for sale' but are shown at their cost as at 1 July 2010. The market value of these assets is sh. 10.5 million. Tax is payable on sale of these assets.

ii) The tax bases of the assets are the same as their carrying amounts in the statement of financial position as at 30 June 2011 except for the following:

	sh. '000'
Property, plant and equipment	2,400
Trade receivables	7,500
Other receivables	5,000

iii) Other intangible assets relate to development costs which were all allowed for tax purposes when the cost was incurred in the year ended 30 June 2009.

iv) Trade and other payables include an accrual for compensation to be paid to employees. This accrual for compensation amounts to sh. 1 million and is allowed for tax purposes when it is paid.

v) Goodwill is not allowable for tax purposes.

vi) Assume a tax rate of 30%.

Required:

Determine the provision for deferred tax as at 30 June 2011. **(15 marks)**

QUESTION THREE

a) Exon Mall Ltd advertises that it gives refunds on faulty products whenever customers purchase at the supermarket. Should a provision be recorded and state your reasons

(5 marks)

b) Embakacy Ltd bought a piece of land in Athi River for the purpose of making cement in 2011. The company will cease operations in 5 years time whereby it will incur environmental clean-up costs of sh. 10 million. The discount rate is 10%. Determine the provision on environmental cleanup and the finance costs for the year 2011 up to 2016.

(10 marks)

QUESTION FOUR

Baraka Ltd was floated with an authorized capital consisting of 20,000 9% preference shares of sh. 100 each, payable sh. 25 per share on application, sh. 25 per share on allotment and sh. 50 per share on first and final call; and 300,000 Equity shares of sh. 10 each, payable sh. 2.50 per share on application, sh. 2.50 per share on allotment and sh. 5.00 per share on the first and final call. Applications were received for the whole of the preference and equity shares. All the money due on the shares was paid with the exception of the amount due to the first and final call on 4,000 equity shares. Prepare the relevant journal entries. **(15 marks)**

QUESTION FIVE

Hilda Ltd is an office equipment manufacturer and its sales have been adversely affected by cheap imports in the office business industry. Profits are expected to fall over the next four years when they are expected to stabilize in the year 2012. The following information is available:

Year ended 31 December	profit before depreciation and tax (sh.)	Capital allowances (sh.)	Depreciation (sh.)
2009	6,250,000	2,000,000	400,000
2010	6,000,000	400,000	800,000
2011	5,500,000	400,000	1,200,000
2012	5,000,000	2,800,000	800,000

Assume a corporation tax rate of 30%. On 1 January 2009 there was a nil balance on the deferred tax account.

Required

The income statement and statement of financial position extracts showing the corporation tax and deferred tax for the years 2009, 2010, 2011 and 2012 using the following methods;

i) Flow-through **(5 marks)**
ii) Full provision **(5 marks)**
iii) Partial provision **(5 marks)**

QUESTION SIX

Elegant Ltd is preparing its first set of financial statements as at 31 December 2011. The provisions/contingent losses under consideration are the following transactions and events.

i) Two of the major product lines sold during the year carries a two year warranty for defects. Sales of these items amounted to sh. 2 million. On average, warranty expenditure approximates 4% of the sales price.

ii) During 2011, Elegant Ltd issued 10,000 coupons. Each coupon held can be turned in within one year from the date on the coupon for a sh. 750 credit on any item sold by the company that costs more than sh. 2,500. The company estimates that 25% of the coupons will be redeemed.

iii) The company was sued by a shopper for sh. 3 million damages due to an accident in the retail store. The shopper asserts a permanent back injury. The legal counsel is of the opinion that it is probable that the plaintiff will prevail in court and that the company will have to pay 10% of the claim and it is anticipated that the insurance will pay the balance.

iv) The comprehensive liability insurance policy carried by Elegant Ltd covers all claims for damages to individuals or groups due to accident, negligence and other injuries related to the legitimate operations of the company. However, the insurance policy carries an escape clause that states "when the insured is willfully negligent as determined by an independent party, 10% of the loss must be paid by the insured".

Required:

a) Evaluate each of the above transactions and events indicating whether the contingent loss is probable, possible or remote while giving reasons.**(5marks)**

b) Recommend appropriate accounting and reporting actions and give any entry where applicable. **(5 marks)**